

CALIFORNIA LOTTERY

Audit Report

LPAS CONTRACT

January 31, 2009, through September 30, 2010



JOHN CHIANG
California State Controller

October 2011



JOHN CHIANG
California State Controller

October 7, 2011

Linh Nguyen, Acting Director
California Lottery
700 North Tenth Street
Sacramento, CA 95811

Dear Mr. Nguyen:

The State Controller's Office (SCO) audited the California Lottery's (Lottery) contract with LPAS for the period of January 31, 2009, through September 30, 2010, and found that the Lottery is not in compliance with the terms and conditions of the Lottery's Contract Manager's Handbook. We noted that the Lottery failed to ensure that invoices were signed and dated by the Contract Manager before payments were processed.

If you have any questions, please call Andrew Finlayson, Chief, State Agency Audits Bureau, at (916) 324-6310.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB/vb

cc: John Menchaca, Commissioner
California Lottery Commission
Alex E. Fortunati, Commissioner
California Lottery Commission
Linh Nguyen, Acting Director
California Lottery
Terry Murphy, Deputy Director
Operations Division
California Lottery
Michael T. Ota, Deputy Director
Finance Division
California Lottery
Roberto Zavala, Chief
Internal Audits
California Lottery

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Audit Report

Summary

The State Controller's Office (SCO) audited the California Lottery's (Lottery) LPAS Contract (No. 13950) for the period of January 31, 2009, through September 30, 2010.

The purpose of our audit was to determine whether the Lottery is complying with sound financial and program management practices in administration of the contract. The audit disclosed that the Lottery was not in compliance with fiscal controls over payments and monitoring of the contract.

Background

By authority of the California Constitution, Government Code section 12410 states, "The Controller shall superintend the fiscal concerns of the state. The Controller shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provision of law for payment." In addition, Government Code section 12411 stipulates that "... the Controller shall suggest plans for the improvement and management of the public revenues."

Proposition 37, the California State Lottery Act of 1984 (Lottery Act), amended the California Constitution to authorize the establishment of a statewide lottery, to create the California Lottery Commission, and to give the commission broad powers to oversee the operation of a statewide lottery.

Pursuant to Government Code section 8880.67, the SCO may conduct other special post-audits of the Lottery, as the State Controller deems necessary. The Controller or his/her agents conducting an audit under this chapter shall have access and authority to examine any and all records of the California Lottery Commission.

The Lottery entered into a contract with LPAS (Contract No. 13950) to provide architectural and engineering services in the design of the new Lottery Headquarters building in Sacramento. The contract maximum amount is \$4.1 million for the period January 31, 2009, through December 31, 2011.

The contractor agreed to provide all labor, materials, equipment, and services for the design and permitting of the new Lottery Headquarters building. Phases of the design project include:

- Schematic Design Phase
- Design Development Document Phase
- Construction Document Phase
- Bid and Award of Trade Work Phase
- Construction Phase
- Post-construction Phase

Objectives, Scope, and Methodology

The purpose of the audit was to determine whether the Lottery's fiscal controls over payments and monitoring procedures are adequate to ensure that LPAS complies with the terms and considerations of LPAS Contract No. 13950 with the Lottery.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The specific objectives of the audit were to determine whether:

- Lottery contract payments are legal and proper;
- The Lottery is abiding with state laws, rules, regulations, and policies with regards to the contract;
- The Lottery is monitoring the contract for compliance; and
- The specified deliverables meet the terms and conditions of the contract.

The audit period was January 31, 2009, through September 30, 2010. Our audit scope included, but was not limited to, the following audit procedures:

- Reviewing LPAS contract and subcontracts, contract law, regulations, rules, Lottery policies, and related accounting records;
- Reviewing work performed by any external audit organization or by any other Lottery unit;
- Interviewing and observing individuals involved in the development, authorization, and monitoring of the LPAS contract;
- Performing tests of procedural compliance and tests of payments, as we deemed necessary; and
- Obtaining an understanding of components of internal controls sufficient to conduct the audit.

We did not audit LPAS's and Lottery's financial statements. We limited our audit scope to planning and performing audit procedures necessary to obtain reasonable assurance that the Lottery's monitoring of the LPAS contract was adequate to ensure compliance with the terms and conditions of the contract and that payments are legal and proper. In addition, we determined whether the Lottery is abiding with state laws, rules, regulations, and policies regarding to the contract.

Conclusion

Our audit disclosed that the Lottery did not follow the procedures stipulated in the Lottery's Contract Manager's Handbook dated in June 2007. These procedures ensure that payments are proper, legal, and reduce the risk of making excessive payments to the contractor. The findings and recommendations section of this report summarizes the control deficiencies noted.

**Views of
Responsible
Official**

The SCO issued a draft audit report to the Lottery dated August 2, 2011. Linh Nguyen, Acting Director, responded by the attached letter dated August 19, 2011. Mr. Nguyen agreed with the finding.

Restricted Use

This report is intended for the information and use of the California Lottery, the California Lottery Commission, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of the final report, which is a matter of public record.

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

October 7, 2011

Finding and Recommendation

FINDING— Lack of invoice approval

The California Lottery did not follow invoice processing procedures for the LPAS contract. We selected seven invoices for testing and found that six out of the seven invoices (Invoice Review and Approval Form) (86%) were not signed and dated by the Contract Manager as required for approval.

In addition, we noted that the Lottery's Accounting Operations and Prize Payment Division (AOPP) processed the invoices for payment without receiving the approved hard copy of the invoice and the Invoice Review and Approval Forms with wet signature and date.

The Contract Manager's Handbook instructs the Contract Manager to sign and date invoices signifying approval of payment. Next, the Contract Manager enters a "release record" into the eProcurement system. Then, the approved invoice is forwarded to AOPP for payment. The Lottery's Contract Manager's Handbook, pages 14 and 15, dated June 2007, states, in part:

Reviewing Invoices: Contractors should submit invoices to Accounting Operations and Tax Bureau in duplicate on letterhead stationary or invoice form. Invoices are then routed to the Contract Manager for review and approval within 5 days of receipt.

Approve the invoice by signing and dating it. Keep a copy in your records.

Enter a release record into e-Procurement. Payments cannot be processed unless this step is performed.

Forward the approved invoice to Accounting Operations & Tax Bureau for payment.

The Lottery's failure to review and approve the invoices was not in compliance with the Contract Manager's Handbook. In addition, the Lottery's failure to adequately review and approve the invoices within five days to ensure that payments made are legal, proper, and accurate reflects inappropriate practices and weak controls over the payment application and approval process.

Recommendation

The Lottery should follow the procedures for approving invoices as outlined in the Lottery's Contract Manager's Handbook to ensure that payments are legal and proper.

The Lottery's Accounting Operations and Prize Payment Division should not process payments until it receives approved invoices containing the Contract Manager's wet signature and date.

Lottery's Response

The Lottery agrees with the finding.

**Attachment—
California Lottery's
Response to Draft Report**

700 North Tenth Street
Sacramento, CA 95811
calottery.com



August 19, 2011

Jeffrey V. Brownfield, Chief
Division of Audits
State Controller's Office
Post Office Box 942850
Sacramento, California 94250-5874

Re: LPAS CONTRACT

Dear Mr. Brownfield:

The California State Lottery (Lottery) offers the following comments regarding the recently concluded audit conducted by your office. The audit scope was limited to an audit of the Lottery's fiscal control over payments and monitoring procedures in LPAS Contract No. 13950.

The Lottery relies on the State Controller's Office (SCO) for objective auditing and recommendations to improve its fiscal controls and we began addressing the finding noted in the draft report. The following is our response:

FINDING – Lack of Invoice Approval

The Lottery did not follow invoice processing procedures for the LPAS contract. Six out of seven Invoice Review and Approval Forms were not signed and dated by the Contract Manager as required for approval. In addition, SCO noted that the Lottery's Accounting Operations processed the invoices for payment without receiving the approved hard copy of the Invoice Review and Approval Form with the wet signature and date.

RECOMMENDATION:

The Lottery should follow the procedures for approving invoices as outlined in the Lottery's Contract Manager's Handbook (Handbook) to ensure that payments are legal and proper.

The Lottery's Accounting Operations and Prize Payment Division should not process payments until it receives approved invoices containing the Contract Manager's wet signature and date.

Jeffrey V. Brownfield
August 19, 2011
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RESPONSE:

The Lottery agrees with the finding. The Contract Manager approved all Invoice Review and Approval Forms accompanying invoices submitted by LPAS for payment as required by the Handbook. However, hardcopies of the Invoice Review and Approval Form were not returned to Accounting as currently required by the Handbook. Although Accounting Operations did not receive hardcopies of the signed forms, approvals were provided by the contract manager electronically through the Lottery's e-Procurement system. This system provides fiscal controls for payment of claims and monitoring of contracts. Without the Contract Manager's electronic approval, Accounting Operations would not be able to pay invoices. The Lottery is in the process of updating its procedures on the invoice approval process and will highlight changes in future updates to the Handbook and Contract Manager training sessions.

If you have any additional questions, please contact my Audit Chief, Roberto Zavala at (916) 822-8358.

Sincerely,


Linh Nguyen
Acting Director

**State Controller's Office
Division of Audits
Post Office Box 942850
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